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ANNUAL REPORT
1985

CORPORATE INFORMATION

Directors:

J. P. Crone, Victoria
R. G. Elliott, Calgary
D. R. Jepson, Calgary
C. V. Kloepfer, Calgary
G. A. Reid, Calgary

Officers:

D. R. Jepson, President
G. A. Reid, Secretary Treasurer
V. F. Maxwell, Assistant Secretary

Head Office:

Suite 205
309 - Second Avenue Southwest
Calgary, Alberta T2P 0C5

Auditors:

Laventhal & Horwath
Penthouse - 1167 Bowness Road Northwest
Calgary, Alberta T2N 3J6

Bank:

The Bank of Nova Scotia
700 - Second Street Southwest
Calgary, Alberta T2P 0N3

Registrar and Transfer Agent:

Montreal Trust
411 - Eighth Avenue Southwest
Calgary, Alberta T2P 1E7

Solicitors:

McDonald & Hayden
800 Sunlife Tower III
112 - Fourth Avenue Southwest
Calgary, Alberta T2P 0H3

Listed On:

The Alberta Stock Exchange
300 - Fifth Avenue Southwest
Calgary, Alberta T2P 3C4

SAN ANTONIO EXPLORATIONS LTD.

March 20, 1986

REPORT TO SHAREHOLDERS TWELVE MONTH PERIOD ENDING DECEMBER 31, 1985

The year 1985 was another busy year for your Company. Listed below are the highlights of activities for the year ending December 31, 1985:

- CAPITAL EXPENDITURES increased to approximately \$3,700,000 from \$2,000,000 in 1984.
- CASH FLOW rose to \$2,639,000 before capitalized interest and G&A in the amount of \$286,600. This compares to the 1984 cash flow of \$1,825,600 before capitalized G&A and interest of \$251,000.
- EARNINGS before Income Tax climbed to \$1,603,000 versus \$919,000 in 1984.
- NET EARNINGS for the year amounted to \$2,441,000 (including an extraordinary item of \$1,264,000) compared to earnings in 1984 of \$705,000.
- PRODUCTION increased in 1985 to an average of 292 BOPD, up from 226 BOPD in 1984.
- In 1985 your company participated in the drilling of twenty-three wells which resulted in the completion of fifteen oilwells, one gas well, two water injection wells and five dry holes.

In the Carrot Creek area the Company drilled one oilwell in each of the Cardium "A" and Cardium "R" pools along with an exploratory dry hole. Considerable progress has been made on the Unitization of the Cardium "R" Pool and an operative Unit is expected by June 1, 1986. The implementation of this Unit and waterflood will increase production 2-1/2 times, bringing your Company's share to over 200 BOPD. Several more locations at Carrot Creek are yet to be tested before the property has been fully evaluated.

Additional oilwells were completed at each of Battle South and Willesden Green. At this time there does not appear to be significant additional drilling in either of these areas.

In September 1985, San Antonio was able to purchase a 9.67% interest in the Joffre Viking Tertiary Oil Unit from Vikor Resources Ltd., for the shares which your Company owned in Vikor and other considerations. As a result, this property is now directly in San Antonio's books rather than in the form of a minority share position in a private Company.

Eight wells were drilled in this Unit during the past summer. Based on the favorable results obtained to date, the Unit owners tentatively approved a \$12,000,000 expansion plan for the project.

However, the substantial erosion of oil prices subsequent to year end has resulted in a temporary postponement of the expansion. Plans call for the resumption of the expansion following the return of higher prices.

After a very busy year in 1985, the Company had planned on considerable activities for the year 1986. However the severe drop in oil prices experienced in the first quarter of 1986 has reduced our projected cash flow by some 50%. This in turn will force your company to adopt a slower development pace. It is our opinion that while the low price drop has been severe, prices should firm and increase substantially going into the fourth quarter of 1986. To the extent that monies are available, the next several months should be an opportunity for the Company.

Your Board would like to take the opportunity to express their thanks to the staff for their continued support and efforts during the past year.

On behalf of the Board,

D. R. Jepson,
President

DRJ/esp

EXPLORATION AND DEVELOPMENT ACTIVITIES

CARROT CREEK

In the summer of 1985 the Company drilled the 6-8 well into the Cardium "A" Pool obtaining ten feet of conglomerate pay which IP'd after completion at some 200 BOPD. The well is currently producing in the order of 100 BOPD. In September the new well 13-16 was completed with approximately 15 feet of Cardium pay. This well IP'd in excess of 200 BOPD and is currently producing its allowable of 60 BOPD. This well along with the 16-16 well will be included in the Cardium "R" Pool Unit which is expected to be operational by June 1, 1986. Amoco will be the Operator of this Unit. Under waterflood, production is expected to be approximately 1500 BOPD, yielding a San Antonio share of 200 BOPD. Continued activities are proceeding with the view to drilling more wells on our Carrot Creek properties.

BATTLE SOUTH

During the year a new well was drilled in Lsd. 9-24-45-20 W4M., resulting in a small Viking oilwell which produces substantial quantities of water. The 5-25-45-20 W4M., well was recompleted as a water disposal well, effecting a significant reduction in costs. In conjunction with this disposal system, a study will be prepared to determine the feasibility of additional injection to increase recoveries.

WILLESDEN GREEN

In Willesden Green another well in Lsd. 16-24-40-5 W5M., was drilled and completed. This well is currently producing some 12 BOPD with your Company having a 19% interest. Depending on stabilization of producing rates and successful reworks, it may be feasible to drill several more wells on this property.

RAINBOW SOUTH

During 1985 the Operator drilled a gas well in Lsd. 11-4-107-9 W6M., and a D&A well in Lsd. 3-8-107-9 W6M. Your Company has a 20% interest in these two wells. The Company is currently drilling another well located in Lsd. 8-17-107-9 W6M. The Company's interest in this project will be 20% before payout with a reversion to 12% after payout. This 8-7 well is being drilled to test the presence of anomalies suggested by a recent 3-D Seismic Program conducted by the project Operator.

JOFFRE

In the summer of 1986 the second stage expansion was undertaken with the completion of eight new wells in the Unit properties. The production from the first stage pilot operation continues to be progressing satisfactorily and based on these results the Unit agreed to a full scale commercial expansion in 1986.

However because of the rapidly falling oil prices in the first quarter of 1986 and the indeterminate nature of future pricing, it is been decided to put this expansion program on hold. This will be reviewed continually to determine the feasibility of proceeding.

PRODUCTION - Barrels

	<u>1984</u>	<u>1985</u>
CANADA		
Alberta	72,604	100,314
Saskatchewan	<u>6,501</u>	<u>2,579</u>
Total	79,105	102,893
NEW MEXICO	<u>3,533</u>	<u>3,522</u>
Total	82,638	106,415
Barrels of oil per day	226	292

HISTORICAL DRILLING ACTIVITY

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
CANADA					
Oil	2	19	11	10	15
Gas	1	2	-	-	1
Other	-	-	6	1	2
Dry	<u>1</u>	<u>15</u>	<u>1</u>	<u>3</u>	<u>5</u>
Total	4	36	18	14	23
UNITED STATES					
Oil	8	5	11	-	-
Gas	-	-	-	-	-
Other	-	-	-	-	-
Dry	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	8	5	11	-	-
Grand Total	12	41	29	14	23

LAND HOLDINGS AS AT DECEMBER 31, 1985 - Hectares

	<u>Gross</u>	<u>Net</u>
CANADA		
Alberta	14,555	3,422
British Columbia	3,866	152
Saskatchewan	377	61
Total	18,798	3,635
U.S.A.	1,216	57
Grand Total	20,014	3,692

RESERVES AS OF DECEMBER 31, 1985 - Barrels

Battle South	79,000
Carrot Creek	1,443,000
Joffre	720,000
New Mexico	25,000
Pinto	28,000
Rainbow	22,000
Willesden Green	17,000
Other Areas	26,000
Total Proven & Probable	2,360,000

These reserve numbers were calculated by the Company's engineers and reflect San Antonio's share of reserves before the deduction of Crown and other Royalties.

The Company is of the opinion that all the reserves are proven with the possible exception of those in the Joffre Tertiary Recovery Scheme. Most enhanced recovery schemes are capital intensive in nature, Joffre being no exception. There is little doubt that the Joffre reserves are technically recoverable, however the price of crude will dictate when they are economically recoverable!

AUDITORS' REPORT

To the Shareholders of
San Antonio Explorations Ltd.

We have examined the consolidated balance sheet of San Antonio Explorations Ltd. as at December 31, 1985 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The comparative figures as at December 31, 1984 and for the year then ended are based on financial statements which were examined by other auditors who expressed an unqualified opinion in their report dated February 4, 1985.

Laventhal & Horwath

CHARTERED ACCOUNTANTS

January 31, 1986

SAN ANTONIO EXPLORATIONS LTD.

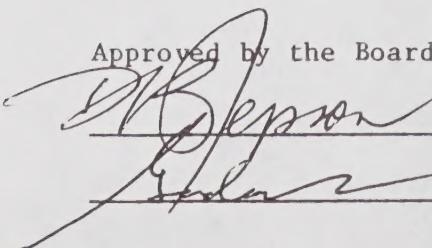
CONSOLIDATED BALANCE SHEETDECEMBER 31, 1985ASSETS

	<u>1985</u>	<u>1984</u>
CURRENT ASSETS		
Accounts receivable	\$ 1,039,541	\$ 646,864
Deposits and prepaid expenses	<u>38,320</u>	<u>16,213</u>
	1,077,861	663,077
PROPERTY AND EQUIPMENT (Note 2)	11,027,604	6,186,920
INVESTMENT IN VIKOR RESOURCES LTD. (Note 3)	—	<u>681,000</u>
	<u>\$12,105,465</u>	<u>\$7,530,997</u>

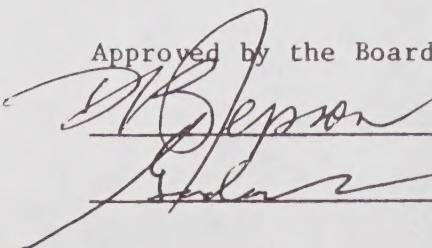
LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES		
Bank indebtedness	\$ 284,413	\$ 120,513
Accounts payable	563,194	791,913
Current portion of long-term debt	<u>304,003</u>	—
	1,151,610	912,426
LONG-TERM DEBT (Note 4)	4,581,657	3,000,000
DEFERRED INCOME TAX	<u>1,739,193</u>	<u>1,020,193</u>
	7,472,460	4,932,619
SHAREHOLDERS' EQUITY (Note 5)	<u>4,633,005</u>	<u>2,598,378</u>
	<u>\$12,105,465</u>	<u>\$7,530,997</u>

Approved by the Board



Director



Director

SAN ANTONIO EXPLORATIONS LTD.

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

YEAR ENDED DECEMBER 31, 1985

	<u>1985</u>	<u>1984</u>
BALANCE BEGINNING OF YEAR	\$1,157,918	\$ 452,931
NET EARNINGS FOR YEAR	2,440,956	704,987
EXCESS OF COST OF SHARES PURCHASED AND CANCELLED OVER STATED VALUE (Note 5)	(85,119)	-
DIVIDENDS	<u>(355,425)</u>	<u>-</u>
BALANCE END OF YEAR	<u>\$3,158,330</u>	<u>\$1,157,918</u>

SAN ANTONIO EXPLORATIONS LTD.

CONSOLIDATED STATEMENT OF EARNINGS

YEAR ENDED DECEMBER 31, 1985

	1985	1984
INCOME		
Sale of oil and gas less royalties	\$3,276,848	\$2,277,530
Other income	<u>176,538</u>	<u>173,018</u>
	<u>3,453,386</u>	<u>2,450,548</u>
COSTS AND EXPENSES		
Production and operating	600,199	391,599
General and administrative	268,280	215,635
Interest	359,555	349,114
Depletion and depreciation	<u>622,389</u>	<u>575,281</u>
	<u>1,850,423</u>	<u>1,531,629</u>
EARNINGS BEFORE INCOME TAXES	1,602,963	918,919
INCOME TAXES (Note 6)	<u>426,218</u>	<u>213,932</u>
EARNINGS BEFORE EXTRAORDINARY ITEMS	<u>1,176,745</u>	<u>704,987</u>
EXTRAORDINARY ITEMS		
Tax benefit realized on utilization of prior years' tax losses	118,635	-
Gain on disposal of investment in Vikor Resources Ltd. (Note 3)	<u>1,145,576</u>	<u>-</u>
	<u>1,264,211</u>	<u>-</u>
NET EARNINGS FOR THE YEAR	<u>\$2,440,956</u>	<u>\$ 704,987</u>
EARNINGS PER SHARE		
Basic - before extraordinary item	\$0.330	\$0.198
- after extraordinary item	0.687	0.198
Fully diluted - before extraordinary item	0.313	0.192
- after extraordinary item	0.652	0.192

SAN ANTONIO EXPLORATIONS LTD.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

YEAR ENDED DECEMBER 31, 1985

	<u>1985</u>	<u>1984</u>
CASH WAS INCREASED (DECREASED) BY		
OPERATING ACTIVITIES		
Operations		
Earnings before extraordinary item	\$ 1,176,745	\$ 704,987
Add items not affecting cash		
Depletion, depreciation and amortization	622,389	575,281
Deferred income taxes	719,000	545,301
Tax benefit realized on utilization of prior years' tax losses	118,635	-
Loss on sale of equipment	<u>1,800</u>	<u>-</u>
	2,638,569	1,825,569
Changes in non-cash working capital		
(Increase) decrease in accounts receivable	(392,677)	280,304
Increase in deposits and prepaid expenses	(22,107)	(1,254)
Decrease in accounts payable	<u>(228,719)</u>	<u>(178,894)</u>
	<u>1,995,066</u>	<u>1,925,725</u>
FINANCING ACTIVITIES		
Increase in long-term debt	1,885,660	87,655
Shares issued for cash	15,000	30,000
Dividends	<u>(355,425)</u>	<u>-</u>
	<u>1,545,235</u>	<u>117,655</u>
INVESTING ACTIVITIES		
Additions to property and equipment	(5,463,073)	(1,874,660)
Purchase of company shares	(65,904)	(22,375)
Investment in Vikor Resources Ltd.	-	(195,750)
Proceeds on disposal of investment in Vikor Resources Ltd.	<u>1,824,776</u>	<u>-</u>
	<u>(3,704,201)</u>	<u>(2,092,785)</u>
DECREASE IN CASH FOR YEAR	(163,900)	(49,405)
BANK INDEBTEDNESS BEGINNING OF YEAR	<u>(120,513)</u>	<u>(71,108)</u>
BANK INDEBTEDNESS END OF YEAR	<u>\$ (284,413)</u>	<u>\$ (120,513)</u>

SAN ANTONIO EXPLORATIONS LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1985

1. SIGNIFICANT ACCOUNTING POLICIES

a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned United States subsidiary, San Antonio Explorations, Inc.

b) Petroleum and Natural Gas Properties

The Company follows the full-cost method of accounting whereby all costs related to the exploration for and development of oil and gas reserves are capitalized in two cost pools, Canada and the United States. Such costs include land acquisition costs, geological and geophysical expenditures, carrying costs on non-producing properties, costs of drilling both productive and non-productive wells, certain administrative expenditures, and interest related to exploration and development activities. For the year ended December 31, 1985, interest aggregating \$81,500 (1984 - \$74,000) and general and administrative expenses aggregating \$205,100 (1984 - \$177,000) were capitalized. Depletion and depreciation of petroleum and natural gas properties and equipment have been provided using the unit-of-production method based on the Company's determination of proven reserves for each cost pool.

The majority of the Company's activities related to exploration and production of oil and gas are conducted jointly with others, and only the Company's proportionate interest in these activities is included in the financial statements.

c) Foreign Currency Translation

Accounts of integrated foreign operations are translated into Canadian dollars as follows: monetary items at the year-end exchange rate; non-monetary items at the historical rates; and revenue and expense items at average rates during the year, with the exception of depletion and depreciation, which are translated at the rate of the related assets. The resulting gains or losses are included in the statement of income.

d) Earnings Per Share

Basic earnings per share are calculated on the basis of the weighted average number of common shares outstanding throughout the year. The weighted average number of shares outstanding for 1985 was 3,555,367 (1984 - 3,566,034).

Fully diluted earnings per share are calculated as if the exercise of the stock options, described in Note 5, had taken place at the beginning of the year.

2. PROPERTY AND EQUIPMENT

	1985		1984	
	Cost (Note 1)	Accumulated Depletion and Depreciation	Cost (Note 1)	Accumulated Depletion and Depreciation
Petroleum and natural gas properties and production facilities	\$13,045,656	\$2,033,799	\$7,596,806	\$1,425,429
Other assets	32,939	17,192	30,970	15,427
	<u>\$13,078,595</u>	<u>\$2,050,991</u>	<u>\$7,627,776</u>	<u>\$1,440,856</u>

3. INVESTMENT IN VIKOR RESOURCES LTD.

	1985	1984
2,550 shares at \$100 per share	\$ -	\$255,000
Note receivable	<u>-</u>	<u>426,000</u>
	<u>\$ -</u>	<u>\$681,000</u>

During the year the company purchased a 9.93153% undivided working interest in Joffre Viking Tertiary Recovery Unit and an interest in certain other net assets of Vikor Resources Ltd. ("Vikor") with a total value of \$1,399,908 in exchange for 1,000 Class B, Series A, non-voting shares of the company.

The company then sold its 2,500 shares of "Vikor" back to "Vikor" in exchange for a cash consideration of \$1,400,576 which resulted in a non-taxable gain of \$1,145,576.

Subsequently the company redeemed the 1,000 Class B, Series A, non-voting shares for a cash consideration of \$1,399,908.

4. LONG-TERM DEBT

	1985	1984
Revolving production bank loan payable with interest at bank prime rate plus 1/2%; at the option of the bank the principal outstanding at June 30, 1986 could be repayable in sixteen equal quarterly instalments commencing September 30, 1986; certain oil and gas properties and a general assignment of book debts are pledged as collateral	\$4,626,424	\$3,000,000
Non recourse, non-interest bearing loan, repayment based on production profits from the Joffre project	<u>259,236</u>	<u>-</u>
Less current portion of long-term debt	4,885,660 <u>304,003</u>	3,000,000 <u>-</u>
	<u>\$4,581,657</u>	<u>\$3,000,000</u>

5. SHAREHOLDERS' EQUITY

		1985	1984		
Share capital		\$1,475,680	\$1,487,210		
Retained earnings		3,158,330	1,157,918		
Shares held for cancellation		<u>(1,005)</u>	<u>(46,750)</u>		
		<u><u>\$4,633,005</u></u>	<u><u>\$2,598,378</u></u>		
Share capital					
Authorized					
Unlimited number of Class A voting shares with no par value					
Unlimited number of Class B non-voting shares with no par value					
Stated capital					
Class A Common		<u>Shares Issued</u>	<u>Held For Cancellation</u>	Charged to Retained Earnings	
		<u>#</u>	<u>\$</u>	<u>#</u>	<u>\$</u>
Balance December 31, 1984		3,598,950	\$1,487,210	31,000	\$ 46,750
Purchased on open market during year				33,700	65,904
Stock options exercised during year		<u>20,000</u>	<u>15,000</u>		
		3,618,950	1,502,210	64,700	112,654
Shares cancelled during year		<u>(64,200)</u>	<u>(26,530)</u>	<u>(64,200)</u>	<u>(111,649)</u>
		<u><u>3,554,750</u></u>	<u><u>\$1,475,680</u></u>	<u><u>500</u></u>	<u><u>\$ 1,005</u></u>
		<u><u><u>3,554,750</u></u></u>	<u><u><u>\$1,475,680</u></u></u>	<u><u><u>500</u></u></u>	<u><u><u>\$ 1,005</u></u></u>

Subsequent to December 31, 1985 the Company purchased on the open market an additional 2,000 shares for an amount of \$4,304. These shares will be cancelled when the appropriate resolutions are approved by the Company's directors.

At December 31, 1985, 190,000 Class A common shares were reserved under the Company's stock option plan in respect of options granted to officers and key employees of the Company. These options are exercisable from time to time up to May 1, 1989, at prices ranging from \$.75 to \$1.60.

6. INCOME TAXES

	1985	1984
Deferred income taxes	\$719,000	\$545,301
Current income taxes	108,946	24,438
Alberta Royalty Tax Credit	<u>(401,728)</u>	<u>(355,807)</u>
	<u><u>\$426,218</u></u>	<u><u>\$213,932</u></u>

6. INCOME TAXES (continued)

The provision for deferred and current income taxes is greater than the provision established by applying a combined Federal and Provincial rate of 47% to pre-tax income. The difference is attributed to the following:

Computing "expected" tax expense at 47%	\$754,240
Permanent differences	
Increase in income tax resulting from non-deductible royalties and other payments to the Crown	415,427
Reduction in income tax due to Alberta Royalty Tax Credit	(401,728)
Reduction in income tax resulting from resource allowance on Canadian resource profits	(357,590)
Miscellaneous	<u>15,869</u>
Net income tax provision	\$426,218
	<u> </u>

The Company's U.S. subsidiary has tax losses in the amount of \$696,000 which may be carried forward to apply against its future income for tax purposes.

7. SEGMENTED INFORMATION

The Company conducts oil and gas activities in both Canada and the United States. The carrying value of identifiable assets at December 31, 1985 and the results of operations for the year ended December 31, 1985, by country, are as follows:

<u>1985</u>	<u>Canada</u>	<u>United States</u>	<u>Consolidated</u>
Total income	<u>\$3,356,922</u>	<u>\$96,464</u>	<u>\$3,453,386</u>
Expenses			
Operating	548,116	52,083	600,199
General and administrative	265,331	2,949	268,280
Interest	359,555	-	359,555
Depletion, depreciation and amortization	<u>534,915</u>	<u>87,474</u>	<u>622,389</u>
	<u>1,707,917</u>	<u>142,506</u>	<u>1,850,423</u>
	<u>1,649,005</u>	<u>(46,042)</u>	<u>1,602,963</u>
Income taxes	(426,218)	-	(426,218)
Extraordinary items	<u>1,264,211</u>	<u>-</u>	<u>1,264,211</u>
Net earnings	<u>\$2,486,998</u>	<u>\$(46,042)</u>	<u>\$2,440,956</u>
Identifiable assets	<u>\$11,272,947</u>	<u>\$699,894</u>	<u>\$12,134,537</u>
Total capital expenditures	<u>\$5,456,666</u>	<u>\$6,407</u>	<u>\$5,463,073</u>

7. SEGMENTED INFORMATION (continued)

1984

	<u>Canada</u>	<u>United States</u>	<u>Consolidated</u>
Total income	\$2,347,320	\$103,228	\$2,450,548
Expenses			
Operating	352,572	39,027	391,599
General and administrative	207,041	8,594	215,635
Interest	349,114	-	349,114
Depletion, depreciation and amortization	474,481	100,800	575,281
	<u>1,383,208</u>	<u>148,421</u>	<u>1,531,629</u>
	964,112	(45,193)	918,919
Income taxes	<u>213,932</u>	<u>-</u>	<u>213,932</u>
Net earnings	\$ 750,180	\$(45,193)	\$ 704,987
Identifiable assets	<u>\$6,755,289</u>	<u>\$775,708</u>	<u>\$7,530,997</u>
Total capital expenditures	<u>\$1,805,709</u>	<u>\$68,951</u>	<u>\$1,874,660</u>

8. RELATED PARTY TRANSACTIONS

Certain directors and officers of the Company own interests in petroleum and natural gas properties in which the Company has an economic interest and is the sub-operator. All transactions with these related parties in connection with these activities are in the ordinary course of business, and the fees charged to the parties are normal to the industry. Amounts receivable from and payable to these related parties included in accounts receivable and accounts payable are \$7,381 and nil, respectively (1984 - nil and \$20,011, respectively).

9. REMUNERATION OF DIRECTORS AND SENIOR OFFICERS

Remuneration paid to directors and senior officers in the year totalled \$168,167 (1984 - \$173,504).

10. CONTINGENT LIABILITY

At December 31, 1985, the Company was contingently liable for a letter of credit issued in favor of Vikor Resources Ltd. in the amount of \$158,900 which is due June 17, 1986. The Company does not anticipate any amount being drawn against this letter of credit.



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